

VZCZCXRO3729
OO RUEHBI
DE RUEHTA #0352/01 0580152
ZNR UUUUU ZZH
O 270152Z FEB 09 ZDK
FM AMEMBASSY ASTANA
TO RUEHC/SECSTATE WASHDC IMMEDIATE 4735
INFO RUCNCIS/CIS COLLECTIVE 1253
RUEHZL/EUROPEAN POLITICAL COLLECTIVE
RUCNCLS/ALL SOUTH AND CENTRAL ASIA COLLECTIVE
RUEHBJ/AMEMBASSY BEIJING 0635
RUEHKO/AMEMBASSY TOKYO 1341
RUEHUL/AMEMBASSY SEOUL 0336
RHEBAAA/DEPT OF ENERGY WASHDC
RUCPDOG/DEPT OF COMMERCE WASHDC
RUEATRS/DEPT OF TREASURY WASHDC
RUEAIIA/CIA WASHDC
RHEFAAA/DIA WASHDC
RHEHNSC/NSC WASHDC 0814
RUEKJCS/SECDEF WASHDC 0730
RUEKJCS/JOINT STAFF WASHDC
RHMFIUU/CDR USCENTCOM MACDILL AFB FL
RUEHAST/USOFFICE ALMATY 1251

UNCLAS SECTION 01 OF 04 ASTANA 000352

SENSITIVE
SIPDIS

STATE FOR SCA/CEN, EUR/CARC, EEB/ESC
STATE PLEASE PASS TO USTDA FOR DAN STEIN

E.O. 12958: N/A

TAGS: [PGOV](#) [ECON](#) [EPET](#) [EINV](#) [KZ](#)

SUBJECT: KAZAKHSTAN: KMG's IDENOV ENTERTAINS, REVEALS

REF: (A) 08 ASTANA 2465 (B) ASTANA 0317 (C) 08 ASTANA 2276

ASTANA 00000352 001.3 OF 004

11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY: On February 25, the Ambassador met Maksat Idenov, First Vice President of KazMunaiGas (KMG), and the government's lead negotiator for all new oil exploration and production deals. Idenov was candid and animated throughout the meeting, which was conducted in English and lasted well beyond the scheduled time. He clearly enjoyed the opportunity to confide in the Ambassador and shared previously undisclosed details of negotiations to explore the N Block, an offshore hydrocarbon-rich reservoir in the North Caspian estimated to contain 2 billion barrels of recoverable oil. Idenov said negotiations to expand the capacity of the CPC pipeline were moving "very slowly" and said the development of KCTS would spur Russia to action and help "jump start" CPC expansion. Idenov was noncommittal on Nabucco and very cautious when discussing the possibility of a trans-Caspian pipeline. Idenov also said the government had "already solved" work permit issues raised by international oil companies and offered his opinion that sulfur is not a "waste product" and thus Tengizchevroil should not be fined for producing and storing it. Idenov was critical of former Kashagan operator Agip throughout the meeting and asked for the Ambassador's assistance to spread the message to companies and government officials alike that "adherence to sound business principles is essential to the future development of Kazakhstan as a civilized society." END SUMMARY.

N BLOCK NEGOTIATIONS IN PROGRESS

13. (SBU) Before the meeting began, the Ambassador was escorted to a private room in the back of Idenov's spacious office suite on the 15th floor overlooking construction of the ambitious, and very expensive, Khan Shatyr entertainment center. On the way, he passed a crowded table of senior Western advisors preparing KMG for negotiations to explore the promising offshore N Block. Idenov left the negotiating table to meet the Ambassador and immediately briefed him in candid and colorful terms on the status of the talks.

NATIONAL PRIDE AT STAKE

¶4. (SBU) Idenov started by saying that ConocoPhillips (Conoco) CEO Jim Mulva, Mubadala chairman Sheikh Mohammed Bin Zayed, and President Nazarbayev agreed on a 40-year tax and royalty contract through 2057, without a tax stabilization clause. Conoco and KazMunaiGas (KMG) would be "joint operators" of the project, with Conoco and Mubadala owning 49 percent of the operating company and KMG owning a majority stake of 51 percent. Idenov then immediately confided to the Ambassador, "Of course, when we say we'll be joint operators, we are only kidding ourselves because we don't have the capability to carry that out yet. But we must say it for matters of national pride." Conoco, Idenov said, will be the "main driver" of the project and will supply the necessary exploration technology, organizational expertise, business processes, and project management.

A PRIVATE LOOK INSIDE THE N BLOCK DEAL

¶5. (SBU) Idenov then abruptly stood up and left the room, returning in a flourish with his personal laptop, which he opened to show the Ambassador an internal presentation on the N Block transaction. As he scrolled through the presentation, Idenov paused to underscore certain points and answer questions. He sounded somewhat like a real estate agent as he pointed out the size of the N Block (more than 8,000 square kilometers, or roughly the size of Japan), and its convenient location near both the Central Asia Center gas pipeline and the Baku-Tbilisi-Ceyhan oil pipeline. He also noted that the water depth of the Block ranges from 30 to 375 meters and its distance from shore ranges from 15 to 90 kilometers. Idenov said KMG has retained an expensive team of world-class business advisors including accountants Ernst and Young, financial advisors Barclays Capital, energy consultants Gaffney Cline, and the law firm of

ASTANA 00000352 002.3 OF 004

Curtis, Mallet-Prevost "not to protect me, but to give me an open, sustainable, honest deal."

PREVIOUSLY UNDISCLOSED DETAILS

¶6. (SBU) As Idenov walked the Ambassador through the presentation, he disclosed several details of the N Block deal that were not previously known (reftel A). For example, he said that Conoco will pay 50 percent of the \$100 million signing bonus when the contract is signed and 50 percent in 2010. He also disclosed that the N Block consortium will pay the government a commercial discovery bonus based on the quantity of N Block's proven reserves. If the consortium discovers less than 1 billion barrels of oil, the bonus will be \$1.50 per barrel; if they discover greater than 1 billion barrels, the bonus will be \$2.50 per barrel. Idenov showed a bar chart showing expected cash flow for the project indicating that Conoco and KMG will incur net losses for the first 10 years of the project. The company is not expected to be in the black until 2017 and will not reach full cost recovery until 2023. Idenov told the Ambassador that the project assumes a price of oil of \$70 per barrel, with \$60 as a break-even point. "At \$40 per barrel," he said, "we're not surviving."

REMAINING ISSUES TO RESOLVE

¶7. (SBU) Idenov was optimistic that the parties would come to agreement on the N Block, but he said they are still working to resolve three remaining issues:

-- Internal rate of return. According to the heads of agreement signed in Astana by KMG, Conoco, and Mubadala on December 5 (reftel A), the project will deliver an internal rate of return (IRR) of 11.75 percent. Since that time, however, the government suspended its crude export duty, which Conoco calculated would raise the IRR to 13 percent. When Conoco CEO Mulva asked the government to raise the IRR for the project to 13 percent, however, Idenov chided Mulva, saying, "Jim, I know the HOA is not a binding agreement, but come on! You can't be serious! You need to negotiate in good faith and honor your previous agreement."

-- Environmental safety. In 1968, according to Idenov, a Soviet

drilling rig exploring the area around the N Block "fell apart and sank." All agree that the wreck might complicate drilling operations, but they have not agreed who will be responsible for removing it and who would be liable for any environmental damage it may cause. Conoco wants the government to remove the rig (or at least pay for its removal and indemnify them against any future liability). Idenov said he offered to carve out the territory on which the rig rests from the N Block acreage, but Conoco balked at the suggestion, because, according to Idenov, they "want creamy butter on their crunchy bread" (i.e., they want to have their cake and eat it too). Idenov said he offered to compensate Conoco for the cost of removing the Soviet rig, if the N Block yields no producing wells.

-- Natural gas sales. Conoco told Idenov that it would like to negotiate the price for any associated natural gas sales up front. Idenov said the government has offered to sell the project's natural gas at the Russia-Kazakhstan border, according to the price determined by confidential agreement between KMG and Gazprom, which he did not disclose to the Ambassador or, for that matter, to ConocoPhillips. Idenov noted in passing that KMG president Kaigeldy Kabyldin will travel to Moscow on February 27 to meet with Gazprom CEO Alexei Miller to discuss this, among other issues.

NABUCCO AND THE TRANS-CASPIAN PIPELINE

18. (SBU) When the Ambassador asked about Kazakhstan's interest in the Nabucco gas pipeline to Europe, Idenov said he is personally very familiar with the project, having studied the possibility of exporting Iraqi gas to Europe via Nabucco when he worked as a vice president for Shell in the Middle East in 2004-06. Without

ASTANA 00000352 003.3 OF 004

commenting specifically on Kazakhstan's interest in participating in Nabucco, Idenov said Kashagan alone contains 140 trillion cubic feet of natural gas, implying that Kazakhstan could become a major gas exporter in the future. When asked about the possibility of a trans-Caspian gas pipeline, Idenov leaned back in his chair, pointed at the ceiling, and said, "That is a question for Zero One," meaning President Nazarbayev. "Only he can answer that question." Idenov added that no work has been done in Kazakhstan on the proposed Caspian littoral ("pri-kaspiskii") gas pipeline, saying, "there's no feasibility study, no funding, no construction."

A DIRECT LINK BETWEEN CPC AND KCTS

19. (SBU) Idenov told the Ambassador that work on the expansion of the Caspian Pipeline Consortium (CPC) pipeline is "slowly moving forward." He said the consortium agreed in December 2008 on the basic principles of expansion, but "there is still no agreement on money." (COMMENT: It was not clear if Idenov was referring to funding for the feasibility study, which we understand has been approved, or BP's sale of its 6.6 percent stake in the consortium, which we understand is still under discussion. END COMMENT). Echoing the comments of Chevron's Jay Johnson (reftel B), Idenov drew a direct link between CPC and the Kazakhstan Caspian Transportation System (KCTS): "Until the Russians see a strong move on KCTS, CPC will struggle." Idenov sounded concerned that KCTS was "not moving" and said Minister of Energy Sauat Mynbayev had asked him to "jump into KCTS" to get things going. Idenov said that as soon as he concludes the N Block negotiations, he will turn his attention to KCTS. "I will start with ExxonMobil," he said, "and push them first. But do you know the real problem with KCTS? It is Chevron, saying, 'We will participate, but if CPC is expanded, we will ship our oil through CPC first.'" Idenov complained that Chevron's attitude threatened to jeopardize the entire project, since no one will begin construction or modernization of pipeline, port, and shipping infrastructure without a firm commitment of supply from the major oil producers.

WORK PERMITS "ALREADY SOLVED"

110. (SBU) When asked why Kazakhstan reduced the number of work permits issued to foreign workers by half in 2009, Idenov told the Ambassador hastily, "That problem has already been solved." When asked to elaborate, he said Pierre Offant, who has been seconded

from France's Total to be the new managing director of the Kashagan consortium, complained that he could not obtain work permits for Kashagan employees, so he took Offant to see Minister of Labor Berdybek Saparbayev. According to Idenov, Saparbayev immediately agreed to grant work permits to Kashagan employees in the first two (skilled labor) categories, but asked that the company show a preference for Kazakhstani candidates in the third category, which Idenov said comprises mainly truck drivers, crane operators, and laborers. Idenov said other large foreign investors should similarly have no difficulty obtaining the necessary work permits. "If Jay Johnson has a problem, tell him to come see me and we'll go to the Ministry of Labor together and work it out," he said. (COMMENT: Idenov did not seem to appreciate the costs, delays, and difficulties associated with resolving work permit issues only on a case-by-case basis with the direct intervention of himself and the Minister of Labor. END COMMENT).

SULFUR NOT A WASTE PRODUCT

¶11. (SBU) Idenov mentioned in passing that in his opinion, sulfur is not a "waste product," but a legitimate, marketable commodity associated with processing Tengiz crude. As a result, Idenov said, Tengizchevroil should not be fined for storing the sulfur produced from the sour gas associated with Tengiz crude. However, Idenov said, "I cannot say this publicly. I cannot openly contradict my government's position. I must be more discreet. But I have made the point privately in conversations with Energy Minister Mynbayev and Deputy Prime Minister Shukevich."

ASTANA 00000352 004.3 OF 004

A PASSIONATE PLEA FOR GOOD BUSINESS PRACTICES

¶12. (SBU) As the meeting came to a close, the conversation turned to standards of good corporate behavior. This is obviously an issue of deep personal concern to Idenov, who began to rail against Western companies operating in Kazakhstan in a way that he said violates international business practices. In particular, Idenov singled out Italy's Agip, saying, "I'm very disappointed in them. Whatever Agip touches either falls apart or violates basic business principles." At Karachaganak, co-operated by Agip and BG Group, Idenov said KMG has already sent one formal notice of dispute and plans to send another soon. In the first case, Idenov said a KMG-sponsored audit by KPMG called into question the operator's claim to recover \$250 million in costs incurred in 2003-2004. In the second instance, KMG plans to ask for an objective, third-party assessment of the operator's decision to spend \$350 million to replace the type of pipelines and metal structures used at the field. "I must send these letters as a matter of principle," he said. "Until we restore good business practices in Kazakhstan, we will not be able to develop as a civilized society." He then added ominously, "When companies continually violate good business practices, they issue an open invitation to the Dark Side of the Force to come in and replace them."

¶13. (SBU) COMMENT: Meeting with Maksat Idenov is always both entertaining and informative. During this latest encounter, his characteristic candor and dramatic flair were on open display, to our pleasure and benefit. Although he may be a prima donna, Maksat is also an astute businessman who has the confidence of President Nazarbayev and the authority to make or break billion-dollar deals for U.S. companies. He has high demands and high expectations for foreign investors operating in Kazakhstan's oil and gas industry, and woe to those who disappoint him. He also has a keen appreciation of Russia's role in Eurasian energy security and is willing to poke and prod Russia when it serves Kazakhstan's interests, for example, on CPC expansion. While we do not agree with Idenov on everything, we understand and support his insistence that international investors conduct business with the highest standards of accountability and integrity and will reinforce this point in private meetings and public speeches to the diplomatic and business communities. END COMMENT.

HOAGLAND